

DOCKET SECTION
BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

RECEIVED

MAR 26 12 26 PM '98

Postal Rate and Fee Changes, 1997

Docket No. R97-1

**NEWSPAPER ASSOCIATION OF AMERICA
MEMORANDUM OF LAW ON THE POUND RATE
FOR STANDARD (A) ENHANCED CARRIER ROUTE MAIL**

March 26, 1998

Robert J. Brinkmann

NEWSPAPER ASSOCIATION OF AMERICA
529 14th Street, N.W.
Suite 440
Washington, D.C.
(202) 638-4792

William B. Baker
Michael Yourshaw
Alan R. Jenkins

WILEY, REIN & FIELDING
1776 K Street, N.W.
Washington, DC 20006-2304
(202) 429-7000

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION AND BACKGROUND	1
A. Background	2
B. The Postal Service's ECR Pound Rate Proposal	4
II. THE POSTAL SERVICE HAS FAILED TO MEET ITS BURDEN OF PROOF FOR REDUCING THE POUND RATE FOR COMMERCIAL ENHANCED CARRIER ROUTE MAIL	7
A. The USPS Has Not Shown That The Current Pound Rate Methodology Is Any More "Illogical" Than First Class Rates	7
B. The Cost Allocation Filed As USPS LR-H-182 (USPS Exhibit 44B) Deserves No Weight	11
1. LR-H-182 is not an analysis of the effects of weight on mail processing and delivery	11
2. LR-H-182 is based on thin data and produces unreliable and bizarre results	12
3. The USPS LR-H-182 allocation largely assumes the result by assuming that most costs are piece-related	17
C. The Proposed Reduction In The Pound Rate Is Based Upon A Competitive Rationale That Is Inappropriate For A Public Service	20
D. The Postal Service's Other Rationales For Reducing The Pound Rate Lack Merit	24
III. THE POSTAL SERVICE'S PROPOSAL TO REDUCE RATES FOR HEAVY ECR MAIL, BUT NOT FIRST CLASS MAIL, IS DISCRIMINATORY	25
IV. CONCLUSION	27

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

Postal Rate and Fee Changes, 1997

Docket No. R97-1

**NEWSPAPER ASSOCIATION OF AMERICA
MEMORANDUM OF LAW ON THE POUND RATE
FOR STANDARD (A) ENHANCED CARRIER ROUTE MAIL
March 26, 1998**

The Newspaper Association of America ("NAA"), by its attorneys and pursuant to Special Rule 5, hereby respectfully submits this memorandum of law regarding the Postal Service's proposal to reduce the pound rate for Standard (A) Enhanced Carrier Route ("ECR") mail by as much as 18 percent. NAA submits that the Postal Service has failed to prove its case. The proposed rate reduction for pound-rated commercial ECR mail is inconsistent with Sections 101, 403(c), 3622(b)(1), (4), and (5) of the Postal Reorganization Act, and should not be recommended. Instead, the Commission should continue to set the pound rate in the same sound and consistent manner as it has since Docket No. R90-1.

I. INTRODUCTION AND BACKGROUND

As NAA stated in its Trial Brief, the most important proposal to NAA members in this case is the Postal Service's proposed drastic reduction in the pound rate for commercial ECR mail. NAA's Trial Brief identified and summarized the policy considerations which dictate rejection of this proposal. In particular, NAA expressed its concern that the Postal Service has lost sight of its fundamental public service mission.

As NAA pointed out in its Trial Brief, the Postal Service now appears more concerned with gaining market share in “competitive markets” through proposals such as the reduction in the pound rate while leveraging its monopoly than with serving the American public. While asking for an overall revenue increase of billions of dollars, the USPS proposes a very modest increase for piece-rated ECR mail, and seeks *decreases* for pound-rated mail. The record leaves no doubt that the Postal Service seeks through the proposed reduction deliberately to encourage the shift of advertising dollars away from newspapers and into direct mail. Ironically, the proposal would not improve USPS finances, as the record suggests that saturation mailers would simply add more weight to their existing packages, rather than generate new mail.¹

The time has come for the Commission to recommend rates that reflect the Postal Service’s public service mission, not its self-created competitive interests. In this memorandum, NAA shows that the Postal Service (and its allies) have failed to meet their burden of proof, and that the Commission must reject the proposed reduction in the pound rate as unjustified and unsupported.²

A. Background

“Above-breakpoint” ECR mail is charged a rate consisting of two elements: (1) a pound rate element (currently 66.3 cents per pound) and (2) a piece rate (currently 1.8

¹ By the USPS’s own data, ECR mail has an elasticity of demand less than one. This means that as the rate declines, the USPS would experience a net loss of revenue.

² While this memorandum specifically concerns the pound rate for Standard (A) ECR mail, many of its comments – particularly on the lack of cost support and discrimination issues – apply to the smaller proposed reduction in the Standard (A) Regular subclass as well.

cents for basic carrier route mail and 0 cents for saturation mail). In setting ECR rates, the Commission has since Docket No. R90-1³ applied a methodology which uses a formula⁴ to compute the pound rate as a consequence of cost-based decisions elsewhere in the rate design. See *Opinion and Recommended Decision*, Docket No. MC95-1 at V-254 & 257, ¶¶ 5642 & 5649 ("*MC95-1 Op*"). The Commission's methodology recognizes the interrelatedness of Standard (A) ECR rates (a concept expressed as the "presort tree") and produces a pound rate that depends "on a host of other ratemaking decisions, all of which are cost based."⁵ *MC95-1 Op* at V-257, ¶ 5649. This methodology is also quite reasonable given the Postal Service's repeated failure over the course of many years to respond to the Commission's requests that it conduct a comprehensive study of the effect of weight on costs for Standard (A)/third class mail.

In Docket No. MC95-1, the Postal Service proposed, as in this case, to abandon the procedure described above, and instead have the rate design witness "select" the pound rate and the minimum per piece rate for both letters and flats. The Commission rejected the Postal Service's proposal to select the pound rate in Docket No. MC95-1, finding that the Docket No. R90-1 method was more cost-based. The Commission

³ The current minimum per piece/per pound rate structure existed in third-class before Docket No. R90-1. However, with the introduction in that case of destination entry discounts, additional presort discounts, and a letter/flat distinction in rate design, the Commission revised its way of setting the pound rate.

⁴ The formula appears in this record at Tr. 6/2826 (Moeller).

⁵ Thus, for example, the Commission's methodology depends upon cost-based decisions as to the passthrough percentages for presort and shape and the piece charge for pound rate mail. See *MC95-1 Op* at V-254, ¶ 5642.

expressed concern that the selection of the pound rate meant that it would no longer depend upon the other cost-based decisions, and that the piece charge proposed in that case no longer reflected presort cost differences.

B. The Postal Service's ECR Pound Rate Proposal

In this case, the Postal Service is again proposing to reduce the pound rate by "selecting" it, rather than following the Commission's methodology. In form, the USPS continues to use the Docket No. R90-1 formula, although in substance it modifies it significantly. See USPS-T-36 at 8-9 (Moeller).⁶ In particular, as in Docket No. MC95-1, the Postal Service proposes not to use the formula's cost-based inputs to determine the pound rate, but rather to "select" the pound rate (which it does in an arbitrary, non-cost-based manner). The USPS concedes that its proposed ECR pound rate is not calculated from costs and does not claim that it has any particular cost basis.⁷ The USPS then runs this arbitrarily chosen pound rate through the formula to calculate (solve for) the piece rate element. As a consequence, both the pound rate and the saturation piece rate are arbitrarily picked; neither is based directly upon costs nor derived from cost-based decisions elsewhere in the rate design.

Using this revised approach, the Postal Service proposes to reduce the pound rate for ECR saturation mail that is entered at the destination delivery unit from the

⁶ NAA does not address in this filing the "first modification" noted by Mr. Moeller, in which the USPS applies revenues from the proposed residual shape surcharge as an offset to revenue reductions from the various Standard (A) ECR discounts.

⁷ Instead, it appears that the rate design witness simply played around with his spreadsheet until arriving at a rate to his liking. Tr. 6/2984, 2989-90 (Moeller).

current rate of 66.3 cents per pound to a new rate of 53 cents.⁸ This compares to a proposed effective pound rate for First Class mail of **\$3.78**.⁹ The Postal Service has made no attempt to justify this gross disparity in rates between First Class and Standard (A) ECR mail.

The Postal Service's support for its change consists of a few pages in the testimony of witness Moeller and a document originally filed as Library Reference USPS-LR-H-182. This latter document subsequently was refiled as Exhibit 44B to the Supplemental Testimony of Michael McGrane. While the Postal Service cited five rationales for this change,¹⁰ this latter document is the only cost support in this record on which it or any other party has relied.

⁸ USPS-T-36 at 31 (Moeller). The 53 cents pound rate element is before destination entry discounts. The proposed discounted pound rate for destination entry saturation mail is 42 cents, compared to the current discounted DDU saturation pound rate of 55.2 cents. The USPS proposes a slight increase to the piece charge rate element above the breakpoint; this makes the net decrease slightly less than the full 20 percent drop from 66.3 cents to 53 cents.

⁹ This is calculated using the proposed 33 cents for the first ounce, and 23 cents for each ounce thereafter up to 16 ounces. Of course, in reality First Class pieces weighing more than 11 ounces pay Priority Mail rates. A piece of Priority Mail weighing one pound pays \$3.00 if it is a single piece, or \$2.89 if it is presorted.

¹⁰ The five reasons are: (1) that the current rate design formula is "illogical" because, for pound-rated saturation nonletters, the rate doubles as weight doubles (although this doubling happens only at the saturation level). USPS-T-36 at 24; (2) that the pound rate no longer serves as a proxy for shape in ECR mail, because parcels constitute only a small share of ECR mail; (3) that the proposed residual shape surcharge further reduces the need for the pound rate to act as a proxy for shape; (4) that the "new cost study" filed as Library Reference LR-H-182 shows that weight plays a "very small role" in ECR costs; and (5) that a lower pound rate is needed because ECR mail "is in a competitive market and is susceptible to diversion to alternative media." USPS-T-36 at 24-26.

Several intervenor witnesses addressed the pound rate in either direct or rebuttal testimony. These include four witnesses sponsored by saturation mailer intervenors who predictably endorsed the change. See SMC-T-1 (Buckel); AISOP-T-1 (Otuteye); SMC-RT-1 (Buckel); ADVO-RT-1 (Crowder). None of these witnesses added any further cost justification for the proposed reduction.¹¹

In addition, several intervenor witnesses submitted testimony critical of the proposed ECR reduction and its rationale. Mr. Bradstreet (AAPS-T-1) and Mr. Green (AAPS-T-2) described the serious threat that the proposals posed to private enterprises in the alternate delivery industry and the serious policy flaws and unsound cost bases for the proposal. From the economic perspective, Dr. Haldi, in testimony for Val-Pak/Carol Wright (VP/CW-T-1), submitted a detailed analysis of flaws in the sole cost support (LR-H-182) on which the USPS relies for its proposal, although he accepted the proposed rate.

A review of the record evidence shows that the Postal Service has failed to prove its case because its cost evidence is unreliable. Moreover, the proposal is both inconsistent with the Postal Service's public service mission and unreasonably discriminatory to the detriment of First Class mailers. Accordingly, the Commission should reject the Postal Service's proposal to modify the Commission's methodology and reduce the pound rate.

¹¹ Witness Crowder devoted a portion of her rebuttal testimony to a discussion of LR-H-182 but supplied no independent cost studies.

II. THE POSTAL SERVICE HAS FAILED TO MEET ITS BURDEN OF PROOF FOR REDUCING THE POUND RATE FOR COMMERCIAL ENHANCED CARRIER ROUTE MAIL

As the proponent of the change in methodology, the Postal Service bears the burden of proof in this proceeding. See 5 U.S.C. § 556(d) (1998); Order No. 1197 at 4 (October 1, 1997). NAA submits that the USPS has failed to carry its burden and that the self-serving testimony of saturation mailers eager for a lower rate suffice does not fill the evidentiary gap.

A. The USPS Has Not Shown That The Current Pound Rate Methodology Is Any More "Illogical" Than First Class Rates

USPS witness Moeller asserts, as his principal critique of the current methodology, that the current rates for above-breakpoint saturation ECR mail are "illogical" because as the weight of an above-breakpoint saturation piece doubles, the rate also doubles.¹² USPS-T-36 at 24. The Commission, however, should require more than merely a rate witness isolating one rate element as "illogical." Section 3622(b)(4) requires, in competitively sensitive areas – and especially where a reduction may have been influenced by pressure from interested mailers¹³ – sound cost evidence and an

¹² This occurs only because the piece rate element for such pieces is, as noted, zero. The Postal Service claims that such a rate pattern is inconsistent with private industry. NAA points out below that no serious evidence concerning private sector pricing has been offered to buttress this claim.

¹³ Tr. 6/3002 (Moeller); see also USPS LR-H-281 at 31 (ADVO Chief Executive Officer quoted in USPS "Blue Ribbon Commission" report as saying that USPS rates "must be more competitive for heavier-weight ad pieces"). Similarly, ADVO's 1997 Annual Report states (at p. 4) that the company "Initiated another postal strategy, following reclassification success in July 1996. The favorable proposal by the U.S. Postal Service, approved by the Board of Governors, would benefit our industry." One suspects that this "favorable proposal" is the pound rate proposal.

explanation of why some mailers are singled out for a reduction and not others, and why that action does not violate the Act's prohibition on discrimination among mailers (see 39 U.S.C. § 403(c)) or treat First Class mailers unfairly or inequitably in violation of Section 3622(b)(1) of the Act.

The Commission has long been concerned about the rate structure for third class/ECR mail, including both its flatness below the breakpoint and, indeed, the pound rate. For this reason, the Commission has consistently complained about the lack of sound cost data, and strongly urged that the USPS conduct a "comprehensive" and "definitive cost study on the underlying third-class structure." *R90-1 Op.* at V-293, ¶ 6048. Yet the Postal Service has repeatedly refused to provide such a study. In this light, witness Moeller's concern about saturation rates doubling with weight rings hollow. In particular, he expresses no qualms about the "illogical" fact that Standard (A) ECR rates *below* the breakpoint remain absolutely flat.¹⁴ Nor does he or any other Postal Service witness express concern about the equally steep (and "illogical") doubling of extra ounce First Class rates with weight.¹⁵

¹⁴ As Dr. James Clifton has pointed out, the flat rate for ECR mail weighing below 3.3 ounces amounts to an extra ounce charge of zero cents for such mail. Tr. 21/10820. This constitutes a substantial bargain for ECR mailers when compared to First Class mailers, who currently must pay 23 cents for each additional ounce.

¹⁵ The concern about rates doubling with weight is somewhat overstated, as this occurs only at the saturation rate level. It is also equally true for automation carrier-route First Class mail under the USPS's current rates. High-density and basic carrier route mail rates, which have a piece rate greater than zero, do not double as weight doubles above the breakpoint.

The Postal Service nowhere explains why a rate structure that is "illogical" for ECR mail is appropriate for First Class mail. First Class rates climb quite steeply with weight (almost doubling),¹⁶ but with two significant differences:

- The steepness begins with the second ounce in First Class mail, while ECR mailers pay no additional rate until 3.3 ounces.
- First Class rates increase at a rate of **23** cents per ounce, a far greater amount than the **4.14** cents per ounce for ECR mail above the breakpoint.¹⁷

Indeed, a comparison of ECR saturation and First Class rates shows that saturation mailers receive an enormous bargain. While the heaviest ECR piece would receive a proposed pound rate of 53 cents, the heaviest First Class piece (11 ounces) would be charged \$2.63 cents under the USPS's proposed rates – *more than two dollars more!* Under the USPS's proposed rates, a First Class piece would need to weigh only **two** ounces to be charged what the USPS proposes to charge a piece of ECR mail weighing just under one pound.

It is indisputable that the Postal Service cannot credibly defend this disparate treatment on the basis of known cost differences. The USPS has virtually no information about the effect of weight on First Class costs. Dr. Clifton, on behalf of ABA/NAA, analyzed the information that does exist and found that the extra costs

¹⁶ Only the fact that the First Class initial ounce pays an even higher amount prevents the total rate from exactly doubling as weight doubles. Under the USPS's proposed rates, a 2 oz. First Class letter would pay 56 cents. A 2 oz. automated carrier rate First Class letter would pay 47.6 cents. A 4 oz. First Class letter would pay \$1.02 and a 4 oz. automated carrier rate First Class letter 93.6 cents. The corresponding rates for 8 oz. letters would be \$1.94 and \$1.85, respectively. See Exhibit USPS-32A (Fronk).

¹⁷ $66.3 \text{ cents} \div 16 \text{ oz.} = 4.14 \text{ cents per ounce.}$

associated with the first and second extra ounces of First Class mail are very small, no more than 2.5 cents. Tr. 21/10831 & 10837. And, as shown below, the Postal Service has no reliable information about the effect of weight on higher Standard mail costs. Therefore, there can be no cost basis for the Postal Service's discriminatory proposals between First Class and ECR mail.

Nor is there any intuitive reason why First Class rates should rise steeply (at a rate of 23 cents an ounce) while ECR rates should not. ECR pieces are often unbound and floppy, lacking the compactness of a sealed First Class letter. First Class mail is often letter shaped, while heavy ECR mail consists of nonletters which are often bulky and difficult to handle. Yet the USPS finds only the saturation rate "illogical." Perhaps this is because First Class mailers remain captive to the Private Express Statutes.¹⁸ Indeed, while reducing the ECR pound rate, the USPS seeks to raise all First Class rates by a penny and also proposes to raise First Class rates further by eliminating the current 4.6 cent heavy-piece discount in First Class mail.¹⁹

No record evidence exists in this record to justify this gross disparity in rates, or selective concern for saturation mail, on service or other non-cost grounds. Labeling one rate in isolation as "illogical" does not suffice to justify a proposal to reduce rates for heavy ECR mail while raising similar rates for heavy First Class mail, and raises questions of discrimination and equity.

¹⁸ It comes as no surprise that the Postal Service regards the First Class extra ounce rate as "an important source of revenue." USPS-T-32 at 23 (Fronk). Perhaps this is why it proposes to retain an implicit cost coverage of 920 percent for the first two extra ounces. See Tr. 21/10831 (Clifton).

¹⁹ See Tr. 21/10825 (Clifton).

B. The Cost Allocation Filed As USPS LR-H-182 (USPS Exhibit 44B) Deserves No Weight

As noted above, the *sole* cost support offered by any party in support of the Postal Service's proposed pound rate reduction is USPS Exhibit 44B, originally filed as Library Reference LR-H-182. Even the Postal Service has been unwilling to place much weight on this document. Perhaps this is because LR-H-182 fails to provide any actual analysis of cost. Rather, it is a cost allocation exercise which uses exceedingly thin data to produce bizarre results, and largely assumes the result through the assumptions that underlie it. For these reasons, it deserves no weight as support for reducing for pound rate.

1. LR-H-182 is not an analysis of the effects of weight on mail processing and delivery

LR-H-182 was prepared by Christensen Associates pursuant to a contract with the Postal Service. It consists of an allocation (on the basis of IOCS piece tallies) of Standard (A) mail processing costs to subclasses of mail by weight increments coupled with a distribution of delivery and other costs based principally on piece volumes.

As Dr. Haldi observed (VP-CW-T-1 at D-7), the Postal Service's attempt to estimate the effect of weight on costs, using IOCS tallies, suffers from an:

almost complete lack of a theoretical foundation concerning (i) how weight affects cost, (ii) which weight-cost relationship the Postal Service is attempting to measure, and (iii) which subset of IOCS tallies (if any) can be expected to shed light on the weight-cost relationship being measured.

Tr. 27/15158.²⁰ In fact, LR-H-182 contains no attempt actually to observe or measure costs; nor is it a time/weight analysis.²¹ It does not arise from a comprehensive analysis of the cost-causative characteristics of Standard Mail (A) pieces of various weight of the type long requested by the Commission. Nor is it a simulation study or even an econometric regression analysis. Tr. 15/7775-76 (McGrane). A better study is certainly possible; yet the record is not clear as to whether a different analysis was ever considered.²²

2. LR-H-182 is based on thin data and produces unreliable and bizarre results

LR-H-182 is fatally flawed as a justification for reducing the pound rate. It suffers from a severe thinness of data in the heavier weight increments which produces ridiculous, widely varying results and renders it far too unreliable to support the USPS's proposal.

Although the Postal Service offers LR-H-182 as a justification for reducing the pound rate charged heavier weight mail, the allocation itself consists of distressingly few tallies of pieces at many increments above the breakpoint weight – which is what it

²⁰ As the Commission knows, IOCS tallies are susceptible to error. See *R94-1 Op.* at III-23-24 (miscount of in-county mail). However, the USPS has no data on the likelihood of errors in the process of recording the weight of pieces during IOCS tally taking. Tr. 19B/8886.

²¹ Real data from actual operations is, of course, superior in cost analysis. Cf. Tr. 29/16198-209 (Crowder) (“real” data is superior to modeled or antiseptic data in testimony on load costs).

²² The Postal Service has stated that there were “no alternative courses of action considered.” Tr. 19A/8569. However, on cross-examination Mr. McGrane testified that he did consider performing a simulation analysis, but did not complete this effort. Tr. 15/7776. No other information about this analysis has been made available.

was supposed to be evaluating. This is especially true in the mail processing costs, although thinness affects in-office costs as well. And, of course, the IOCS does not attempt to measure carrier street costs.

The actual numbers of tallies for mail processing costs by ounce increment are presented in the record. Tr. 15/7730 & 7766 (McGrane). These data show, for example, that the mail processing cost estimates for pieces weighing 9 ounces or more are based on ten or fewer direct tallies for any such increment for commercial ECR mail and, in one weight increment only **one** tally for the year across the entire United States! Tr. 15/7797-98 (McGrane). Remarkably, these are the weight ranges targeted for the steepest rate decreases.

And even at lower weight increments, such as five to six ounces, no more than 30 piece tallies were recorded for five ounces, and barely half that number for six ounces. Fewer than 20 total tallies were recorded at the 7 ounce increment. Tr. 15/7730 (McGrane). The tallies are even thinner for nonprofit ECR mail; only **three** piece tallies weighing more than four ounces were recorded for the entire year. *Id.*²³

The thinness of these tallies produces widely gyrating results. The document purports to show, for example, that the average unit costs of ECR mail, as presented in Table 1 of LR-H-182, jump as follows:

²³ And there appears to be reason to doubt the validity of even these few tallies. See Tr. 22/11801 (Haldi [ANM]) stating that IOCS tallies contain many errors for Standard (A) Nonprofit mail); Tr. 30/16391 (Haldi).

<u>Weight</u>	<u>Estimated Unit Cost</u>
1 oz.	6.6 cents
3	5.1
4	7.1
5	5.1
8	9.1
10	7.8
11	9.9
12	9.0
13	6.6
14	13.0

USPS-ST-44B, Table 1. According to LR-H-182, the attributable cost of a 13 ounce piece of ECR mail is the same as for a one ounce piece, and that a four ounce piece costs 39 percent more than *either* a three ounce piece *or* a five ounce piece. Tr. 15/7657 (McGrane).

Moreover, Dr. John Haldi, in testimony submitted by Val-Pak/Carol Wright pointed out that the unit costs estimated in Tables 1 and 2 of LR-H-182 (which present estimated unit processing and delivery costs for all ECR mail and ECR flat mail respectively) are contradictory. For example, he points out that the estimated unit cost for flats exceeds the total unit cost for all ECR mail. Tr. 27/15160.²⁴ As Dr. Haldi notes, they “dance up and down, for no discernible reason, and in no systematic manner.”

*Id.*²⁵

²⁴ Dr. Haldi subtracted the unit costs for ECR flats presented in Table 2 of LR-H-182 from the unit costs for all ECR mail. The result is an estimate of unit costs for ECR letters and parcels combined. The results were negative unit costs for ECR letters and parcels at five different weight increments. Tr. 27/15160.

²⁵ Dr. Haldi concludes: “Serious weight cannot be given to data for flats when the ‘residual’ produces results such as these.” Tr. 27/15160.

As initially filed, LR-H-182 made no attempt to adjust for dropshipping and presortation characteristics. Tr. 15/7783. Yet some mail receives "full service" from the USPS, while other mail is heavily presorted or entered at destination offices.²⁶ To the extent that the mix of functions used by ECR mail is correlated with weight, LR-H-182 accordingly suffers from a bias. Even after being adjusted for these factors in the curious manner Mr. McGrane chose, however, the unit costs continue their random ride for no apparent reason.²⁷ For example, the adjusted unit costs change from 4.48 cents at five ounces to 4.23 cents at seven ounces, then jump by more than 50 percent to 6.79 cents at eight ounces. See Tr. 15/7638 & 7790-91 (McGrane). Inexplicably, the adjusted unit cost for commercial ECR mail offered by the Postal Service drops to 3.62 cents at 13 ounces, but then jumps to 9.08 cents at 14 ounces. Tr. 15/7638 (McGrane).

Not only do the overall cost estimates presented in LR-H-182 vary wildly above the breakpoint, but it is not possible to conduct such routine tests of their statistical accuracy such as standard errors of estimates. Tr. 15/7793 (McGrane).²⁸ However, it is possible to calculate coefficients of variation for the mail processing costs used in the allocation. See Tr. 15/7752. For above-breakpoint weight increments, the coefficients of variation for ECR mail are quite large, and even exceed 100 percent at one

²⁶ This phenomenon also distorts the current method of assigning institutional costs, which currently assumes that all mail makes the same relative use of postal functions. See Tr. 25/13261-13292 (Chown).

²⁷ In a lengthy interrogatory response, Mr. McGrane attempted to adjust for these factors by normalizing each weight increment so that it would have the same average dropship and presortation profile as for the entire subclass. Tr. 15/7785.

²⁸ This is because the USPS allocation uses mail volume estimates from a non-sampled system.

increment. *Id.* Indeed, the coefficient of variation is greater at every weight increment for commercial ECR mail than for Standard Regular mail. Tr. 15/7750 & 7799 (McGrane).

Mr. McGrane (and ADVO rebuttal witness Crowder) stated that these variations or the thinness of the underlying data are not troubling because these results are consistent with similar studies in the past. Tr. 15/7792-93. But there is no evidence that the prior studies were any better or based on any greater number of tallies. Tr. 15/7829 (McGrane). Nor did prior IOCS studies even attempt to account for carrier costs.

Indeed, even the testimony of other Postal Service witnesses undercuts the credibility of LR-H-182. For example, Postal Service witness Degen, whose testimony similarly depends heavily on IOCS tallies, testified that for the IOCS system, the larger the sample, the better. Tr. 17/8184. Mr. Degen's testimony also supports the proposition that where data behave strangely, there is reason to suspect the accuracy of the data. Tr. 17/8179.²⁹

Perhaps more to the point, Mr. McGrane's colleague at Christensen Associates, Dr. Talmo, testified that in statistical analysis, "if the population is very uniform with very low variability, you do not need very many sample points to characterize that group." Tr. 16/7957 (Talmo). Here, of course, there is no evidence either that the population is uniform or of low variability. In response to a question from the Chairman, witness

²⁹ Mr. Degen also testified that if the IOCS data that he uses were subject to human error and erratic reporting, the "data wouldn't behave themselves." Tr. 17/8179. It follows that where the data are erratic, there is reason to doubt their reliability.

Talmo stated that he was unaware of any situation where the variability in a given category is so small that a single tally might be representative. *Id.*

In part, the problem may stem from the IOCS itself. Dr. Haldi, testifying for Val-Pak/Carol Wright, focused on unsuitable nature of the IOCS as a means of evaluating the effect of weight on costs. He notes that the USPS faces “multiple weight-cost relationships” that render futile an effort to identify a global weight-cost relationship. Tr. 27/15159; *see also id.* at 15155. He adds that the IOCS system is particularly ill-suited for such an analysis, because IOCS tallies do not identify at what point in the postal system the sampled piece of mail was entered. Tr. 27/15159.

In an effort to defend its approach, the Postal Service (in an interrogatory later adopted by Mr. McGrane) took the remarkable position that LR-H-182 “was not intended to measure specific cost relationships between individual weight cells, but rather to provide the overall relationship between weight and cost for Standard Mail (A).” Tr. 15/7657. Mr. Bradstreet aptly refuted this attempted defense:

If a study intended to establish weight/cost relationships cannot even come close to measuring “specific cost relationships between individual weight cells” without more questionable cost numbers than realistic numbers, and if it can’t even produce a clearly discernible graphic trend between 1-ounce and 13-ounce pieces, *what good is it?* Why would the Postal Service be so anxious to embrace such results?

Tr. 23/12016. The Commission should give no credence to LR-H-182.

3. The USPS LR-H-182 allocation largely assumes the result by assuming that most costs are piece-related

That LR-H-182 concludes that the costs of above-breakpoint Standard (A) Mail are mostly piece-related should come as no surprise. The document allocates costs

based on assumptions that bias the results in precisely that direction, a circular approach the Commission should soundly reject.

LR-H-182 lists the assumptions used in its preparation at pages 2 and 3. USPS-ST-44B at 2-3 (McGrane). As a review of these assumptions makes evident, the document simply assumes away any possibility that delivery costs are weight-related, and it does so by allocating *all delivery costs*, both city and rural, in proportion to mail volume by pieces. USPS-ST-44B at 3. This constitutes an assumption that delivery costs are 100 percent piece-related. Tr. 15/7778 (McGrane).³⁰ For carrier-route mail, these delivery costs constitute nearly half of the estimated costs allocated by Mr. McGrane. See USPS-ST44B at 8-9.

LR-H-182 also assumed that carrier street time costs do not vary by shape (Tr. 15/7778), and that elemental load costs are the same regardless of the weight of the piece. Tr. 15/7780. Mr. McGrane made these assumptions to “simplif[y] the analysis.” Tr. 15/7708. Strangely, while the McGrane allocation of elemental load time costs takes shape into account (Tr. 15/7708), Mr. McGrane knew of no study ever of the effect of *weight* – his subject – on elemental load time costs. Tr. 15/7780.³¹

³⁰ LR-H-182 also allocates all residual costs by piece volumes as well. These include costs in segments 1, 2, 4, 9, 11, 12, 13, 15, 16, and 18 not otherwise accounted for by the use of piggyback factors. Most of these costs – including the delivery cost segments 7 and 10, were accounted for by piggyback factors and thus were allocated in the same piece-relationship as the direct costs in those segments. Tr. 15/7656 (McGrane). The residual costs, representing about three percent of the attributable costs of ECR mail, were allocated by piece volumes. Id.

³¹ On cross-examination, Mr. McGrane testified that he does not believe that a letter carrier incurs any addition cost in lifting a 10 ounce piece from the satchel and loading it into a receptacle than in lifting and loading a one ounce piece. Tr. 15/7780. He did acknowledge, however, that the carrier’s costs may be affected by factors such
(Continued...)

Of course, no witness has testified that weight has no effect on delivery costs. See Tr. 15/7708 (McGrane). The assumption that delivery costs are entirely piece-related is disavowed even by the Postal Service. For example, Mr. Moeller testified that he does not believe that weight has no effect on delivery costs. Tr. 6/2806 (Moeller). More to the point, USPS witness Nelson contradicts this central assumption by demonstrating that weight does, in fact, affect route driving time. See USPS-T-19 at 6; Tr. 15/ 7708 (McGrane). Yet LR-H-182 assumes that these weight-related costs simply do not exist.

Assuming away weight-related delivery costs in LR-H-182 renders it “obviously . . . biased in the direction of understating weight-related costs.” Tr. 27/15195 (Haldi). Candidly, Mr. McGrane conceded that the weight/cost relationship found in his allocation “follows from the assumptions” he made. Tr. 15/7778. While the USPS acknowledges that delivery costs are not entirely piece-related, it contends that the costs are mostly related to pieces and not weight. The USPS’s defense for this proposition, however, is not realistic.

Mr. Bradstreet’s testimony demonstrates why LR-H-182’s assumption that delivery costs are predominantly piece-related cannot be accepted as sound. Drawing from his years of experience in the private delivery industry, Mr. Bradstreet testified that “in any delivery, there is a significant weight/cost relationship at the point of delivery.”

(...Continued)

as the floppiness of the piece, whether it is open-ended or stapled, or other characteristics not addressed in LR-H-182. Tr. 15/7780-81.

Tr. 23/12011.³² Yet, as Mr. Bradstreet points out, the only costs that LR-H-182 "selected for study are those which are low to begin with, and which disappear with local entry and route pre-sorting and pre-sequencing." Tr. 23/12011.

In rebuttal testimony on behalf of ADVO, Inc., witness Crowder (ADVO-RT-1) attempted to reargue the merits of LR-H-182. But her testimony provides no independent cost data, but rather relies on LR-H-182 and manipulates it in different ways. If a study's data are unreliable, those data remain unreliable no matter how they are manipulated.

To summarize, the most direct response to LR-H-182 comes in the words of Mr. Bradstreet: "Any weight/cost study that fails to study the impact of weight on the most obvious weight driven costs, but simply assumes there is none, is a rigged study." Tr. 23/12011. As such, LR-H-182 deserves no weight by the Commission.

C. The Proposed Reduction In The Pound Rate Is Based Upon A Competitive Rationale That Is Inappropriate For A Public Service

NAA's Trial Brief has already discussed the serious public policy concerns that arise when an agency of the federal government focuses on leveraging its government

³² Mr. Bradstreet posed an example of a city carrier delivering 600 pieces of ECR mail. Mr. Bradstreet points out that if that mailing weighed ¼ ounce per piece, then the total mailing would add only 9.4 pounds to the carrier's daily load. If the mailing weighed 3.3 ounces apiece, the total weight would rise to 124 extra pounds of mail. And if the pieces weighed 13 ounces each, the total weight of that mailing alone would soar to 487 pounds for the carrier. Tr. 23/12013. His key assumption is that the ECR mailing is added to the carrier's other mail. There can be no doubt that the added pounds lead directly to "slower progress and likely some extra trips to the vehicle," thus raising costs. Yet LR-H-182 simply assumes these obviously weight-related costs away. Tr. 23/12014 (Bradstreet). In contrast, when asked a hypothetical question about additional costs created by a seven ounce saturation mailing, the Postal Service

(Continued...)

privileges and competing with the private sector by specifically tailoring its rates for the benefit of selected mailers, rather than for the benefit of the general public. See NAA Trial Brief at 10-12. The Postal Service's targeting of a unjustified rate reduction for selected ECR mailers, while continuing to burden First Class mail, is a clear example of a federal agency that has lost sight of its purpose, as assigned by Section 101 of the Act. Compounding these policy concerns is the lack of information on which the Postal Service has proceeded and its apparent unconcern about the consequences of its actions on the private sector.³³ Such an approach contravenes Section 3622(b)(4) of the Act, which requires consideration of the effect of rate changes on private competitors.

That the reduction in the ECR pound rate is competitively motivated cannot seriously be disputed. One of the Postal Service's justifications for the pound rate reduction is a desire to be more "competitive" with the private sector. USPS-T-36 at 26 (Moeller) (stating that because the ECR¹ subclass "is in a competitive market and is susceptible to diversion to alternative media. . . . the rate structure should be sensitive to, and priced competitively with, the alternatives").³⁴ This is confirmed by the testimony of the saturation mailer witnesses in support of the proposal and the selectiveness of the reduction. Yet even were "competitiveness" an appropriate justification for singling

(...Continued)

chose to assume that the carrier has *no other mail to deliver*. Tr. 15/7654 (McGrane). Such unrealistic assumptions deserve no credence.

³³ See Tr. 23/11991 (Bradstreet).

³⁴ As Mr. Bradstreet points out, a major rationale offered by the Postal Service for creation of the Enhanced Carrier Route subclass in Docket No. MC95-1 was a desire to be more "competitive" with private alternatives. See Tr. 23/12001.

out one type of mail for favored treatment, the Postal Service has failed to prove this claim as well, as it has offered absolutely *no* evidence of what the “competition” charges.

The selectiveness consists of more than simply favoring Standard (A) mail while jacking up First Class rates yet again, but extends even to the beneficiaries of the reduction. Only ECR flats – the type of mail that principally competes with private delivery companies and newspapers for advertising -- would receive a rate reduction under the USPS proposal.³⁵ The pound rate does not affect the rate paid by letters in any way. Even above-breakpoint parcels are targeted for an increase through the proposed residual shape surcharge. This remarkable selectivity occurs despite the fact that the USPS denies any distinction among letters, flats, or parcels in the competitiveness of commercial ECR mail. Tr. 6/2724 & 2997 (Moeller). If there is “no distinction” between letters, flats, and parcels, the singling out of flats for a reduction is plainly arbitrary.

There is record evidence, however, that mailers may have urged the Postal Service to propose to reduce the pound rate. Cross-examination disclosed that mailers had expressed in meetings with USPS personnel a desire for a reduced pound rate. Tr. 6/3002 (Moeller). And the Chief Executive Officer of ADVO, Inc., is quoted in the “Blue Ribbon” report *Finding Common Ground* as saying that USPS rates “must be more

³⁵ Standard Regular flats would receive a slight decrease as well.

competitive for heavier-weight ad pieces." See Library Reference LR-H-281 at 31 and 32.³⁶

Given Mr. Moeller's testimony that the USPS should reduce the ECR pound rate to be more competitive with media, it is astonishing that the Postal Service purports to know as little as it does about other media pricing. Evidently the Postal Service's research consisted of little more than only a cursory review of materials dating from before Docket No. MC95-1 more than 2 ½ years earlier (Tr. 6/2997), and a brief search of a few Internet web sites (Tr. 6/2997-98). Even these data are as much as three years old. Tr. 6/2998. Nothing in the testimonies of Mr. Buckel or Mr. Otuteye provides any significant additional information.

For a competitively motivated proposal, the Postal Service also shows a distressing ignorance of the possible consequences to the alternate delivery industry that is unworthy of and inappropriate for a governmental agency. That the USPS did not see a need even to consider the net revenue of the leading private delivery company is unworthy of a government public service. Tr. 6/3002. Thus, there is no reason to believe that the USPS has offered a sufficient showing under Section 3622(b)(4).

The evidentiary breach was filled, however, by the testimony of Mr. Bradstreet and Mr. Green on behalf of AAPS. Their testimonies eloquently describe the serious

³⁶ For the selection and composition of the Blue Ribbon Committee, see Tr. 19B/8878. That the Postal Service is deliberately reducing rates to target newspaper advertising is further evident from its 1998 Marketing Plan. See NAA LR-NAA/R97-1 LR 2 at AD Page 11 ("Pre-printed inserts have been and will continue to be the single newspaper application which is most vulnerable to diversion to Ad Mail").

threat to their livelihoods presented by the USPS proposal, which is a factor under Criterion 4 as well as pertinent to the public policy implicated in such actions.

While saturation mailers eagerly anticipate additional business volume in response to the reduced pound rate, there is not a shred of evidence that any such increase would improve USPS finances. Indeed, the evidence points the other way. Commercial ECR mail has a demand elasticity of less than one; therefore, a reduction in rates would actually *reduce* the USPS's net revenue. Furthermore, if the saturation mailers merely add an additional insert to a mailing – making it heavier – that would produce no new volume for the Postal Service.

The Postal Service's proposal to reduce only the ECR pound rate while again sticking First Class mailers with a rate increase is not the even-handed approach one would expect from a governmentally provided public service. Postal rates should be set fairly and equitably, not discriminatorily for the benefit of certain mailers with which the Postal Service may feel a partnership. NAA does not believe that it is appropriate for the U.S. Postal Service, as an establishment of the federal government, to favor some mailers to the detriment of other sectors of the economy. And favored mailers certainly should not be the recipient of a rate reduction on the basis of such skimpy evidence as in this case.

D. The Postal Service's Other Rationales For Reducing The Pound Rate Lack Merit

The remaining rationales offered by Mr. Moeller for reducing the ECR pound rate are insufficient to overcome the other deficiencies pointed out herein.

Mr. Moeller testified that, after reclassification, weight is no longer a proxy for parcels in commercial ECR mail. He states that only a relatively small percentage of commercial ECR mail consists of parcels after reclassification and that even for those parcels, the proposed residual shape surcharge would be a more direct way of charging for the assumed additional costs of parcels.

This rationale fails to carry the day. As the Commission has stated previously: "Weight, in fact, is a proxy for all cost-causing factors, not simply for shape." *R90-1 Op.* at V-291, ¶ 6045. Indeed, this situation does not appear any different from the state of affairs in Docket No. MC95-1 when the Commission rejected a similar proposal to reduce the pound rate. And the record is quite barren of evidence regarding the types of parcels in ECR, their weight, and whether their other physical characteristics increase costs more. Finally, of course, even these rationales, slender as they may be, vanish altogether if the Commission does not recommend the proposed parcel surcharge.

III. THE POSTAL SERVICE'S PROPOSAL TO REDUCE RATES FOR HEAVY ECR MAIL, BUT NOT FIRST CLASS MAIL, IS DISCRIMINATORY

As a public service provided by the federal government, the Postal Service should provide services indifferently to the public at cost-based rates and not favor some sectors over others or make other unreasonable distinctions between mailers. This principle is embodied in Section 403(c) of the Postal Reorganization Act. The USPS's proposal to reduce rates substantially for ECR mailers, while raising rates for First Class mailers, is an example of selective and unreasonably discriminatory conduct

that ill-befits a government provided public service and violates this limitation on the power of the USPS.

The Postal Service is certainly in no position to contend that its discriminatory treatment of ECR mail, compared with First Class mail, is reasonable because it is cost-based. First, the USPS has provided *no evidence whatsoever* on the effect of weight on costs for First Class mail. Section II above pointed out the absence of reliable cost support for the proposed rate reduction for ECR mail; even if this were a credible analysis, it would not support disparate treatment of First Class mail. Indeed, as noted above, there are reasons to suggest that the costs for First Class mail -- particularly workshared mail -- may be even less than for ECR mail of similar weight.

Second, the record is clear that the 53 cent pound rate proposed by the Postal Service itself has no particular cost basis. That figure is not the result of a careful analysis of costs developed either top down or "bottom up" or even from LR-H-182 (Tr. 6/2788); it is the fruits of Mr. Moeller's playing around with a spreadsheet. Tr. 6/2984. Plugging a guesstimate into the Commission's formula simply produces a piece element charge that has no particular basis in costs. By comparison, the Commission's traditional way of setting the pound rate relies on a series of cost-based decisions throughout ECR rate design, and is cost-based as a consequence of these other cost-based decisions.

Finally, the USPS not only proposes an ECR pound rate that is not cost-based, but it also has offered no proposal at all regarding how to avoid an unreasonable discrimination by reducing First Class rates as well -- just the opposite, it proposes to leave the extra ounce rate unchanged while *raising* the initial ounce rate, thereby

raising rates for all First Class mail – itself questionable under Section 3622(b)(5), which directs the Commission to protect First Class mail from excessive rates! Absent such a showing, the Postal Service's proposal to reduce the commercial ECR pound rate to non-cost-based levels while raising First Class rates is discriminatory and inequitable. Therefore, it violates Sections 403(c), 3622(b)(1), and 3622(b)(5) of the Postal Reorganization Act.


IV. CONCLUSION

For the foregoing reasons, as well as for those discussed in its Trial Brief filed previously, the Newspaper Association of America respectfully requests the Commission to issue an Opinion and Recommended Decision that rejects the Postal Service's proposed change in the method of setting the commercial Standard (A) Enhanced Carrier Route pound rate element and rejects its proposal to reduce the pound rate element.

Respectfully submitted,

NEWSPAPER ASSOCIATION OF AMERICA

Robert J. Brinkmann
NEWSPAPER ASSOCIATION OF AMERICA
529 14th Street, N.W.
Suite 440
Washington, D.C.
(202) 638-4792

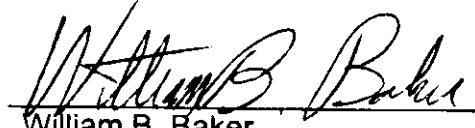
By: 
William B. Baker
Michael Yourshaw
Alan R. Jenkins

WILEY, REIN & FIELDING
1776 K Street, N.W.
Washington, DC 20006-2304
(202) 429-7255

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the instant document on all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

March 26, 1998



William B. Baker